

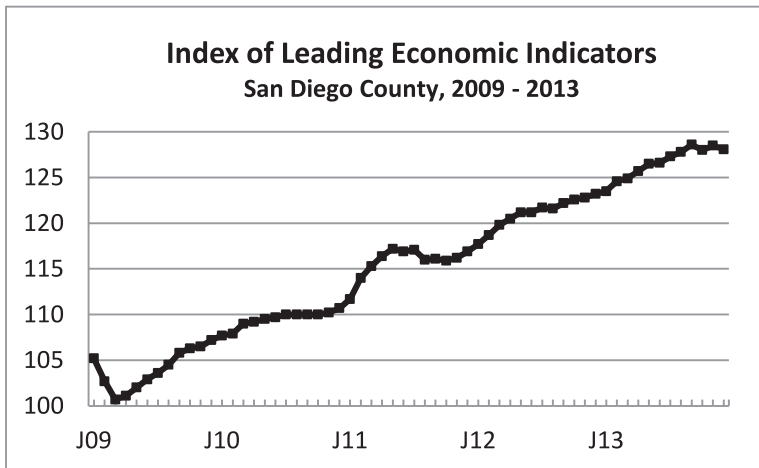
CITY OF CARLSBAD BUDGET HIGHLIGHTS

increase, and DataQuick indicates that median prices in California climbed to \$376,000 in March, an increase of 20.1 percent compared to last year. However, the number of homes sold in March reached the lowest level (24,565) since 2008. Construction activity, both residential and non-residential, are expected to grow through 2016, as are taxable sales.

San Diego County shows improvement in unemployment and home prices. The unemployment rate hit 6.9 percent in March, an improvement from 7.8 percent, last year. The county added 32,600 jobs over the year ending in March, but many of these jobs were created in lower-paying sectors, such as leisure and hospitality. As Marney Cox, chief economist for the San Diego Association of Governments (SANDAG) points out, "It will be another mediocre year [2014]. Nothing substantial." San Diego's economy is also predicted to suffer from military cutbacks, which will negatively impact tourism and taxable sales.

Home prices continue to rise in San Diego County. According to DataQuick, the median price for a residence rose by almost 12 percent (to \$426,000) in March, compared to a year ago. The Case-Shiller Home Price Index indicates that San Diego has some of the highest price appreciation in the nation with a year-over-year increase of almost 20 percent in February. Monthly appreciation (February over January) was more than 1 percent. Sales volume fell by almost 19 percent in March, compared to the prior year. Residential building permits increased by 46 percent in 2013, the strongest showing since 2006, with much of the increase in multi-family residential.

The chart below reflects historical movement in the USD's Leading Economic Indicators. The index, which measures local stock prices, help wanted advertising, and other pertinent metrics, turned mildly negative (-0.2 percent) in the last month of 2013.

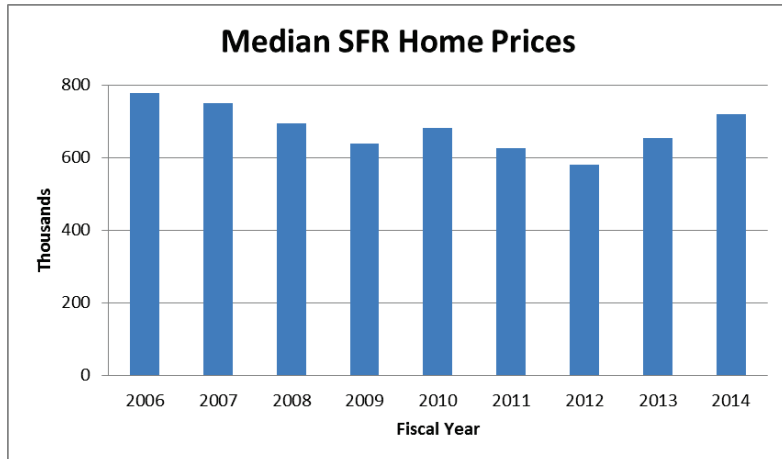


Carlsbad's economy is tied closely to that of the San Diego region. For FY 2013-14, property taxes decreased by 2.5 percent compared to the prior year, primarily due to one-time revenues received from the dissolution of the Redevelopment Agency in FY 2012-13. Transient Occupancy Tax (TOT), a gauge of the health of local tourism, is expected to end FY 2013-14 with an 8.6 percent increase over last year, due to the additional room inventory and

improving occupancy and daily rates. Sales tax revenues are expected to end FY 2013-14 with an increase of 6.2 percent due to the continuing strength in retail and auto sales. Overall, General Fund revenues are projected to decrease by less than one percent compared to the prior fiscal year, but will increase substantially (3.8 percent) in FY 2014-15.

CITY OF CARLSBAD BUDGET HIGHLIGHTS

Housing prices in Carlsbad are following national, state and regional trends. Data on single family residence (SFR) sales from DataQuick indicate that the median sales price increased to approximately \$720,000 in the first quarter of 2014, an increase of over 10 percent compared to the same quarter in 2013. According to Movoto, inventory of units for sale have increased in Carlsbad, from 255 units in



April 2013 to 337 units for sale, this April. The total assessed values in the city are close to \$24 billion, an increase of 1.9 percent compared to the prior fiscal year (FY 2012-13). According to recent growth projections prepared for the city, Carlsbad will add 920 residential units over the next five fiscal years.

From 1992 to 2008, commercial and industrial development in Carlsbad averaged approximately 1.1 million square feet per year. As opportunities for new development diminish, commercial and industrial development is tapering off, falling to an average of approximately 162,000 square feet per year over the next five fiscal years. Large industrial and commercial developments in the next five years include Carlsbad Raceway and Palomar Forum, Dos Colinas Retirement Community, and the Floral Trade Center. Commercial office space vacancy has witnessed a decline over the past several years, falling from over 30 percent in the last quarter of 2009 to just under 20 percent in the first quarter of 2014. Industrial vacancy fell to 10.1 percent from 12.4 percent, last year.

Commercial development has brought much needed entertainment and shopping venues to citizens and visitors alike, as well as generating additional sales taxes to help pay for city services. Carlsbad is home to Car Country Carlsbad – an auto mall; the Carlsbad Premium Outlets – a specialty outlet center; Plaza Camino Real – a regional shopping mall; a Costco center; and the Forum at Carlsbad – a commercial center with upscale retail shops, restaurants and other commercial uses. A new Lowe's opened in fall 2013, and La Costa Town Square is scheduled to open in FY 2014-15.

Development has also enhanced Carlsbad's reputation as a destination resort for tourism. The city is host to a major family theme park, Legoland, and has two luxury resorts available for its visitors, the Park Hyatt at Aviara and the La Costa Resort & Spa. There are also a number of other quality hotels and motels in the city, with the most recent additions being the Hilton Oceanfront Resort & Spa and the Legoland California Resort.

The City of Carlsbad opened a municipal golf course in the summer of 2007 which has further enhanced the tourism attractions the city offers. The municipal golf course, The Crossings at Carlsbad, is an 18-hole, destination golf course set in the rolling hills and canyons of Carlsbad. With ocean views, high quality golf experience, a first class restaurant and clubhouse, and linkages to hiking trails, The Crossings at Carlsbad is a destination spot for golfers and non-golfers alike.

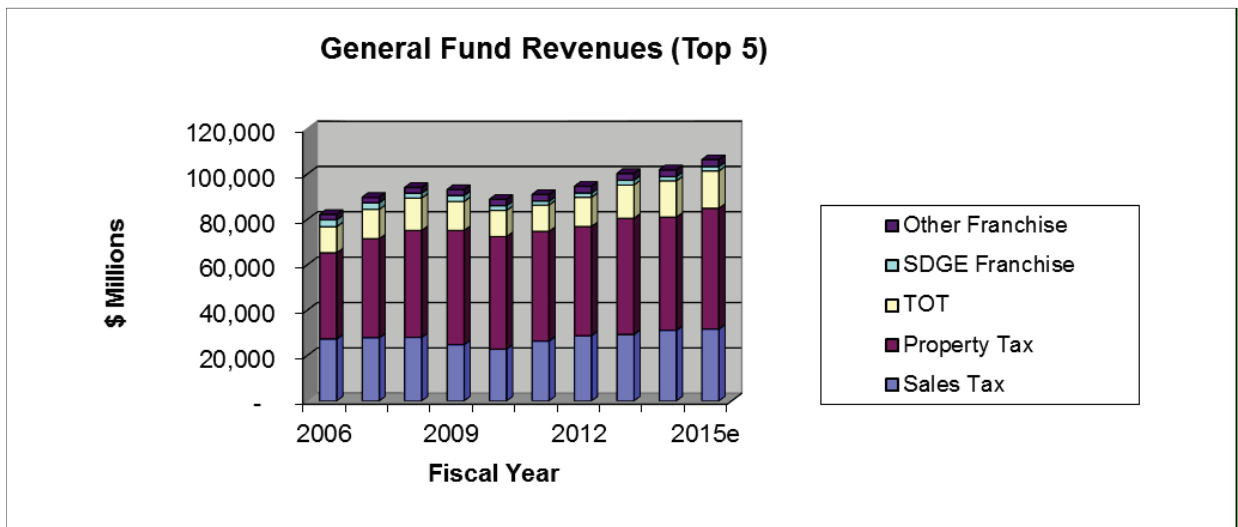
It is the Council's goal to ensure that the city remains in good financial health, and there are a number of steps the city has taken to attain that goal. One of the steps is the Growth Management Plan. This plan was adopted by the citizens to ensure that all necessary public

CITY OF CARLSBAD BUDGET HIGHLIGHTS

facilities were constructed along with development. It also ensures that a financing plan is in place to pay for the facilities prior to the development of the property.

In addition to the Growth Management Plan, the city also prepares a long-term financial model for both the capital and operating needs of the city. With a growing city such as Carlsbad, it is imperative that we plan for the impacts of the economy, serving new development and operating new public facilities, as well as planning for capital needed to build them. Thus, the city prepares a ten-year operating forecast for the General Fund, and a 15-year Capital Improvement Program. As part of the Capital Improvement Program, the city annually calculates the amounts needed to pay for the various projects, and calculates the anticipated operating budget impacts. In this way, the city can anticipate the effects of development from both a capital and an operating perspective.

One important initiative the city has undertaken to ensure its financial health is the development of an Infrastructure Replacement Fund. With this fund, the city sets aside a portion of General Fund revenues on an annual basis for major maintenance and replacement of its infrastructure. Much of the city's infrastructure is relatively new; thus, the city is just now experiencing the impact of maintenance requirements. By setting aside funds now, the citizens of Carlsbad can be assured that the proper maintenance and replacement, as needed, will be performed on streets, parks and many facilities for which the city is responsible.



As national and local economic conditions begin to improve, Carlsbad is well positioned to reap the benefits of a diverse business composition. Over the past decade, the city has developed an economic base that attracts business, tourism, and retail consumers. The city hosts four regional shopping areas within its boundaries; an auto mall, a large regional mall, an outlet center, and a high-end retail center in the southern part of the city called The Forum. A strong tourism industry is served by Legoland and a host of resorts and hotels, as mentioned previously. All of these factors, combined with relatively stable property values, provide a strong revenue base to support the high level of city services for our residents. In FY 2014-15, the city is expected to generate \$101.4 million, or 79 percent of General Fund revenues, from three main sources: property taxes, sales taxes, and transient occupancy taxes (TOT).

Overall, for FY 2014-15, General Fund revenue is projected to increase by 4.8 percent from the previous year's estimates. Most major sources of tax revenue are expected to increase slightly in FY 2014-15, including property tax (6.6 percent increase), following several years of stagnant growth. Sales tax is expected to increase by 1.8 percent and TOT revenues are projected to increase by 3 percent as occupancy and average daily rates (ADR) increase and new hotels,

CITY OF CARLSBAD BUDGET HIGHLIGHTS

such as Legoland, continue to draw visitors. Home values are showing substantial appreciation, which is expected to improve assessed values in the coming years. Development related revenue items are forecast to increase modestly in FY 2014-15, due primarily to an increase in commercial and industrial activity, as compared to the previous fiscal year.



State of California – In January, Governor Jerry Brown submitted a balanced budget to the California legislature. The passage of Proposition 30, which temporarily increases income tax rates and sales tax rates, increased revenue projections and, coupled with budget cuts made in past years, allowed the governor to claim a fiscal balance for the first time in over a decade.

The budget for FY 2014-15 relies on projected revenues of \$108.7 billion to cover \$106.8 billion in expenditures. The budget also addresses the “wall of debt” that was built up by the state in earlier budget cycles, as it attempted to cover shortfalls. Under the governor’s plan, this debt of \$24.9 billion will be eliminated by the end of FY 2017-18. The budget also sets aside \$1.6 billion in a budget stabilization account to allow the state to face future uncertainties. Of course, the state still has looming fiscal issues to tackle, including unfunded pension liabilities of over \$217 billion dollars for state workers, teachers, university workers, and judges. The state also relies heavily on capital gains taxes (these will account for \$4 billion in additional revenue in FY 2014-15) and this revenue source has proven extremely volatile in past years. The budget also assumes that the federal court will grant a two-year extension to California’s requirement to meet the capacity threshold of its prisons, which is uncertain. Finally, Proposition 30 is temporary, and the sales tax increase expires in 2016, followed by expiration of the income tax increase in 2018.

California, as mentioned previously, continues to face sizable pension liabilities. The reform enacted under Assembly Bill 340 should decrease pension costs in the long-run, but more reforms are being proposed, including a measure proposed by San Jose Mayor Chuck Reed, which would effectively allow cities to change pension benefits going forward for public employees. General Fund expenditures in the proposed budget increased by 8.5 percent, with significant increases in K-12 education and transportation, while revenues are expected to increase by 5.9 percent in FY 2014-15.

Looking Forward

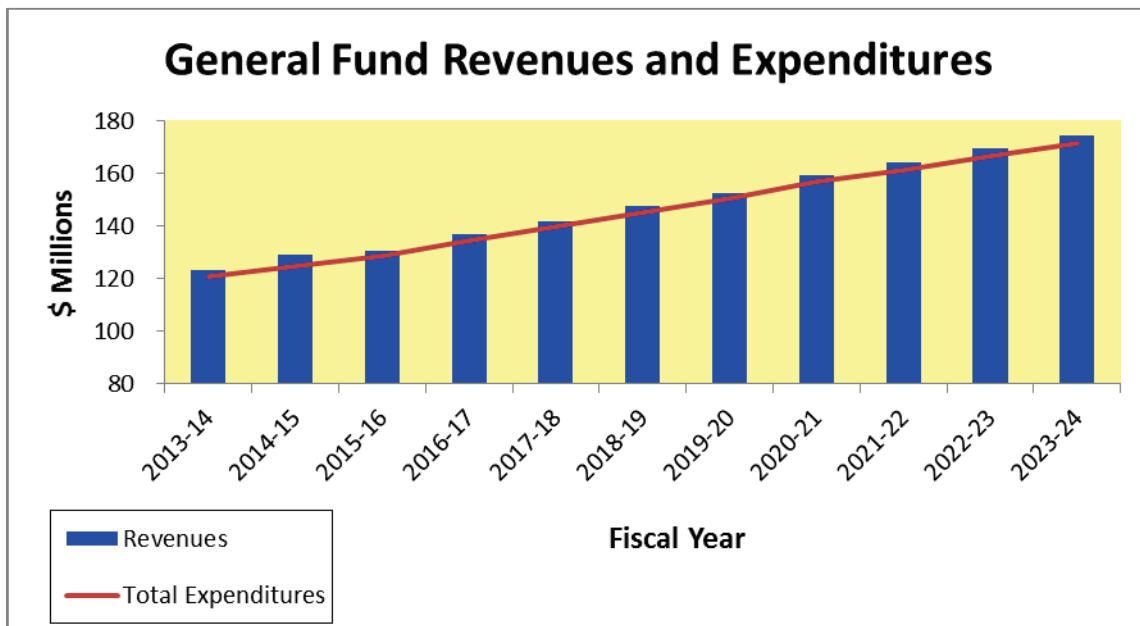
In order to strategically address the future needs of the city and to ensure that we maintain a structurally balanced budget in the long term, the city prepares a ten-year financial forecast. Revenue projections are developed based on current and forecasted economic variables at the national, state, and local levels, and provide city leaders with some measurement of future capacity to support city programs and services. In recent years, revenue growth has become more difficult to project in the long-term, as we find ourselves in an economic climate that changes rapidly and unpredictably, and the forecast allows decision makers to adjust for these changes. The ten-year forecast is updated frequently to avoid potential pitfalls and to ensure that we identify and resolve fiscal challenges and continue to develop a balanced and responsible budget.

Over the past several years, the city has addressed the budgetary challenges brought on by the recent recession and taken deliberate measures to continue to allocate resources in a responsible manner, minimizing the impact to users of city services. These measures included a reduction in full-time and hourly full-time equivalent (FTE) positions, delaying the construction of non-essential capital projects, reducing the funding for capital outlay and goal projects, reducing and/or eliminating cost of living salary increases, requiring employees to pay a larger portion of their retirement costs, using technology and other tools to create efficiencies, and reducing certain non-essential service levels with a minimal impact to the community.

CITY OF CARLSBAD BUDGET HIGHLIGHTS

The ability to anticipate changes in revenue sources and to balance those resources against the costs related to ongoing and future programs, services, and infrastructure requirements is critical to the financial health of the city. The city relies on the General Fund forecast to effectively manage fiscal resources and map a sustainable and responsible path for attaining the goals of the community. The tumultuous economic environment experienced in the past few years makes this long-term perspective even more important.

The forecast assumes limited growth in residential and commercial development over the next decade and captures the expected revenue impacts from major projects that are expected to be completed during the forecast period. Ongoing transfers to the Carlsbad Crossings Golf Course are expected to continue over the forecast period; however, the transfer is expected to decrease steadily over the ten-year forecast horizon. The operating costs of new city facilities projected in the Capital Improvement Program and supported by the General Fund, such as Alga Norte Park, are also captured in the forecast. Economic conditions at the national, state, and local level are expected to continue improving at a modest rate and to provide a boost to most of our major sources of revenue. Home prices, which have been slumping for several years, are continuing to increase substantially and will begin to provide a boost to the city's property tax revenues in the following years. Overall, the outlook for General Fund revenues has improved, since the last fiscal year, and revenues are expected to exceed ongoing operating costs.



The forecast assumes that General Fund revenues will increase by less than five percent in FY 2014-15, as improving economic conditions buoy revenues from the property taxes, sales taxes and TOT. To project the expenditures, all known changes in personnel and maintenance and operations costs are accounted for. However, the effects of future negotiations with employee bargaining units are not contemplated in the current ten-year forecast. The city is currently undertaking an evaluation of services in order to pursue a managed competition process, known as Best Value Services. The financial impact of a change in service delivery is also not considered in the ten-year forecast.

The forecast assumes that the city's cost for employee health care will increase by five percent, annually, over the life of the forecast. Pension plan costs continue to be a major driver of overall personnel costs for the city. CalPERS, the pension plan which funds city employee pension benefits, has recently decided to substantially increase required annual pension

CITY OF CARLSBAD BUDGET HIGHLIGHTS

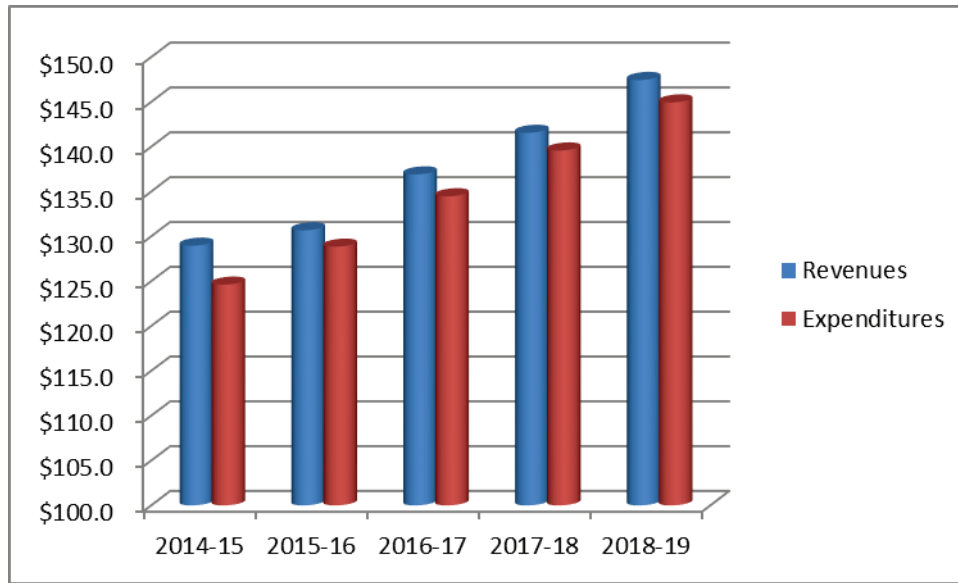
contributions from participating agencies in order to fully fund outstanding pension obligations within 30 years. This decision, coupled with new mortality assumptions (pensioners are living longer), will substantially increase personnel costs for the city and are contemplated in the current ten-year forecast. The cumulative effect of the five year ramp-up in pension costs will increase the General Fund's annual contribution by 45 percent from FY 2015-16 to FY 2019-20. The forecast further assumes that no new positions are authorized after FY 2014-15, except those that may be related to the operating costs of new city facilities supported by the General Fund. Negotiated salary step increases and cost of living increases are included in personnel costs, in order to provide a conservative estimate of future costs. The contribution from the General Fund to the Infrastructure Replacement Fund is forecasted to remain at 6.5 percent of General Fund revenues. Finally, the forecast includes estimated operating costs for all capital projects in the timeframes shown in the Capital Improvement Program (CIP).

As indicated in the graph on the previous page, the General Fund is balanced for FY 2014-15 and revenues exceed expenses over the life of the forecast. Although the revenue forecast is optimistic, Carlsbad is still exposed to a fragile and slowly recovering economy, which could rapidly deteriorate and adversely affect local revenues. Despite these threats, responsible fiduciary stewardship and planning have placed the city in a position to benefit from even modest improvements in the economic environment.

GENERAL FUND FIVE YEAR FORECAST					
	2014-15	2015-16	2016-17	2017-18	2018-19
REVENUES					
Property Tax	\$ 53.3	\$ 54.6	\$ 57.2	\$ 59.1	\$ 61.0
Sales Tax	31.7	32.7	34.4	36.2	37.5
Transient Occupancy Tax	16.5	17.5	18.5	19.4	20.3
Franchise Taxes	5.0	5.0	5.1	5.2	5.2
Business License Tax	3.8	4.0	4.1	4.2	4.3
Development Revenues	2.5	0.9	1.1	0.7	1.5
All Other Revenues	16.3	16.0	16.4	16.8	17.7
Total	\$ 129.0	\$ 130.7	\$ 136.9	\$ 141.5	\$ 147.4
EXPENDITURES					
Personnel	\$ 78.3	\$ 81.7	\$ 85.2	\$ 88.9	\$ 92.7
Maintenance & Operations	34.7	35.1	36.8	37.9	39.1
Capital Outlay	-	0.3	0.4	0.4	0.5
Council Contingency	1.5	1.5	1.5	1.5	1.5
Transfers	10.1	10.2	10.6	10.9	11.2
Total	\$ 124.6	\$ 128.8	\$ 134.5	\$ 139.6	\$ 144.9
SURPLUS/(DEFICIT)	\$ 4.3	\$ 1.8	\$ 2.4	\$ 2.0	\$ 2.5

(In millions)

CITY OF CARLSBAD BUDGET HIGHLIGHTS



The **Appropriations Limitation** imposed by Proposition 4 and modified by Proposition 111 (Gann Limit) creates a restriction on the amount of revenue which can be appropriated in any fiscal year. The revenues which are subject to the limitation are those considered "proceeds of taxes." The basis for calculating the limit began in Fiscal Year 1978-79 and is increased based on population growth and inflation. Carlsbad's appropriation limit is in excess of three times the annual appropriation of proceeds of taxes subject to the limit. With such a large margin (approximately \$250 million), and in light of the city's ten year financial forecast, there is no time in the foreseeable future where Carlsbad's annual appropriation of tax proceeds would approach the limit. It is unlikely the Gann Limit will ever be reached in the future.

FINANCIAL POLICIES

The city has formally adopted a number of financial policies to not only safeguard city assets, but also to assist in ensuring long-term financial stability.

General Fund Reserve Policy - The city's General Fund reserve policy sets a minimum reserve of 30 percent of the General Fund operating expenditures. In addition, the policy sets a target reserve of 40 percent to 50 percent of General Fund operating expenditures. The minimum reserve may be used for cash flow needs necessitated by unforeseen emergencies, while reserves in excess of the minimum will be used only for one-time uses associated with unexpected events, such as economic downturns or temporary reductions in revenues. In general, General Fund reserves will be used for one-time uses only. The reserve level, which includes the unassigned fund balance, will be calculated using the prior fiscal year's adopted General Fund budgeted expenditures.

Investment Policy - The city has also established a formal Investment Policy. It is the policy of the City of Carlsbad to invest public funds not required for immediate day to day operations in safe, liquid and medium-term investments that shall yield an acceptable return while conforming to all California statutes. It is intended that the policy cover the investment activities of all contingency reserves and inactive cash under the direct authority of the city. Investments of the city and its component units will be made on a pooled basis; however, investments of bond proceeds will be held separately if required.

Policy for Financing of Public Improvements – Council Policy 33 outlines the city's policies for financing public improvements, primarily to complete links in the city's traffic circulation

CITY OF CARLSBAD BUDGET HIGHLIGHTS

system. Improvements generally include streets and highways, sewer lines, water lines, drainage facilities, and other improvements as authorized by law and which the City Council has determined are consistent with the policy.

The underlying principals behind the policy are:

- To protect the public interest;
- To ensure fairness in the application of the assessments, special taxes, or fees to current and future property owners;
- To ensure full disclosure to current and future property owners of the special district;
- To ensure the creditworthiness of any special district debt;
- To protect the city's credit rating and financial position;
- To ensure that the applicants for special district proceedings, other than city-initiated proceedings, pay all costs associated with the formation of any special district;
- To establish one policy regarding the requirements that must be met before the City Council will consider approving the financing of public improvements using special districts;
- To provide city staff, the residents of the city, and owners and developers of property located within the city with guidance in the application for and consideration of the establishment of special districts; and
- To incorporate the requirements of new legislation pertaining to the use of special districts.

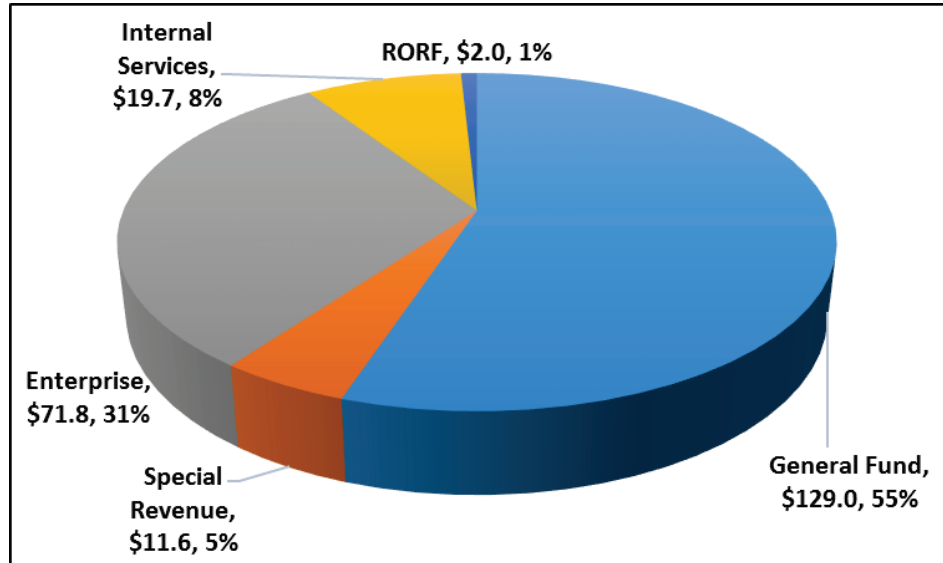
The policy provides the framework for use of Assessment Districts, Community Facilities Districts, and Bridge and Thoroughfare Districts. The public improvements must be located in the public rights-of-way dedicated or otherwise granted to the city or other public agency, and construction of the improvements must serve the public interest as well as the benefit conferred on the properties within the proposed financing districts. The Policy describes property owner requirements such as concurrence of a certain percent of property owners wishing to establish the special district, financial capability and stability of the property owners and proposed project, as well as the steps of the formation process.

OPERATING BUDGET

Revenue Projections

The city's operations are divided into various funds. Each fund has been established because of certain restrictions placed on the use of the resources received by that fund. Any unrestricted funds are placed in the General Fund. Estimated revenues for the city's five fund types are shown on the accompanying graph.

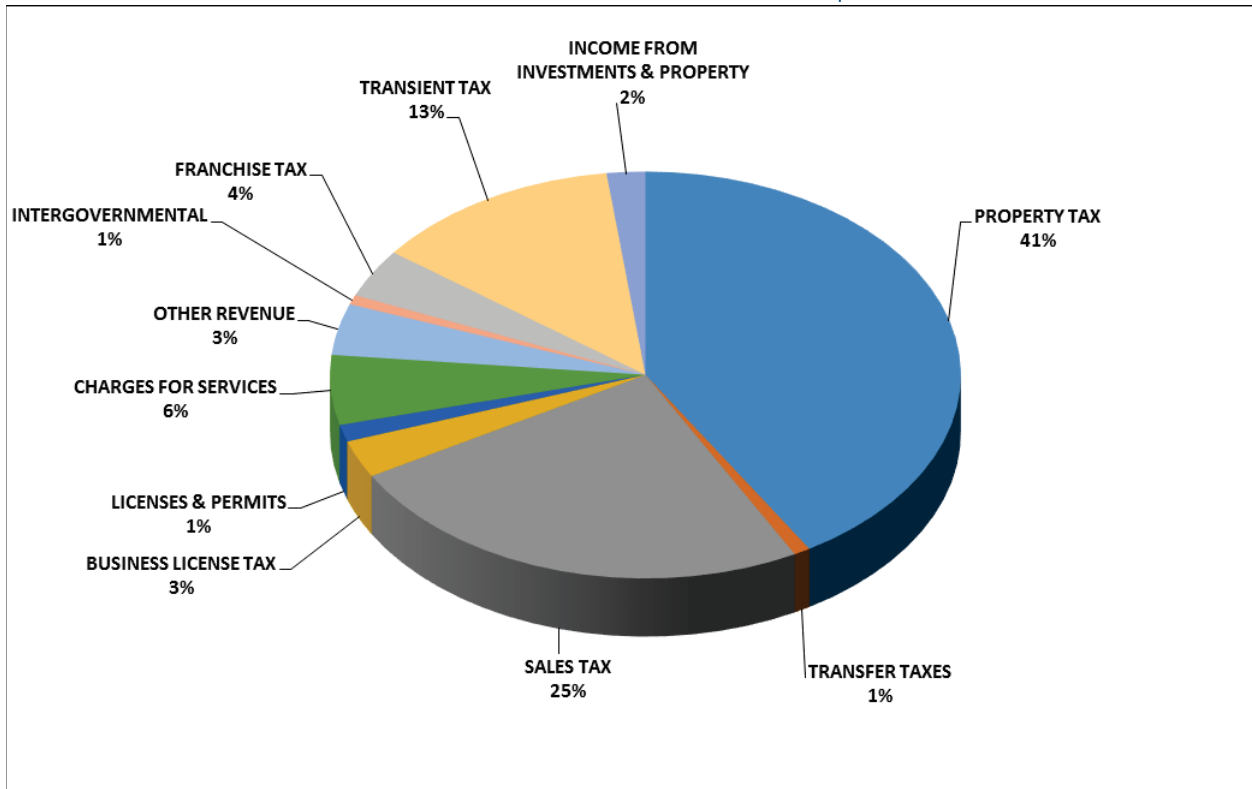
**FY 2014-15 OPERATING REVENUES
BY FUND TYPE = \$234.1 MILLION**



General Fund

The fund receiving the largest slice of the revenues is the General Fund, with estimated revenues of \$129 million for Fiscal Year 2014-15. The General Fund pays for most of the city services available to city residents. The majority of the General Fund revenues are derived from taxes. The following graph illustrates the sources of revenue to the General Fund.

FY 2014-15 GENERAL FUND REVENUES = \$129 MILLION



CITY OF CARLSBAD BUDGET HIGHLIGHTS

Property taxes, at \$53.3 million, are the largest General Fund revenue. The city receives only about 18 percent of the property taxes paid by its citizens. The remainder of the tax goes to the school districts, the state, and other various agencies. Sales tax is the second largest source of revenue for the General Fund. Sales taxes are estimated to bring in \$31.7 million for Fiscal Year 2014-15. Automobile and retail sales are the most significant contributors to the category of sales tax.

Transient occupancy taxes (hotel taxes) are estimated at \$16.5 million and represent the third largest revenue source for the city. Franchise taxes, transfer taxes, and business license taxes make up the remaining \$9.9 million in tax revenues estimated to be collected in Fiscal Year 2014-15.

Intergovernmental revenues are revenues collected by the State and other governmental agencies and allocated to the city based on a formula. Examples of intergovernmental revenues include motor vehicle license fees, State mandated cost reimbursements, and homeowner's exemptions. Intergovernmental revenues are estimated at approximately \$1 million for the upcoming year.

Licenses and permits account for \$1.7 million of the General Fund revenues and include building permits and other development-related permits. Charges for services are estimated to be \$7.1 million and include fees for engineering, planning, building, recreation, and ambulance services. Income from investments and property are estimated at \$2.5 million.

Other General Fund revenue sources include charges collected from other departments, fines and forfeitures, and miscellaneous revenues. Those sources total \$5.3 million.

Special Revenue Funds

Revenues from Special Revenue funds are estimated at \$11.6 million for Fiscal Year 2014-15. Funds collected in this category are legally restricted to specified purposes. Examples of funding resources include donations, grants, and special assessments. The types of functions supported with Special Revenue funds include programs such as Section 8 Housing Assistance, Housing Trust Fund, Community Development Block Grants (CDBG), and maintenance and assessment districts.

Enterprise Funds

Enterprise funds revenues make up the second largest revenue group, totaling \$71.8 million. Enterprise funds operate similar to a business in that they charge fees to cover the cost of their services. Examples of the city's enterprises include water and wastewater services and solid waste management. This fund group also includes operations of the city's municipal golf course, The Crossings at Carlsbad.

Internal Service Funds

Internal Service fund revenues, projected to be \$19.7 million, are derived from charges to the city programs that benefit from the services rendered. The funds collected must be used specifically to support the internal service. Examples of the city's Internal Service funds include General Liability, Self-Insured Benefits, Information Technology, Workers' Compensation, and Vehicle Maintenance and Replacement.

Redevelopment Obligation Retirement Funds

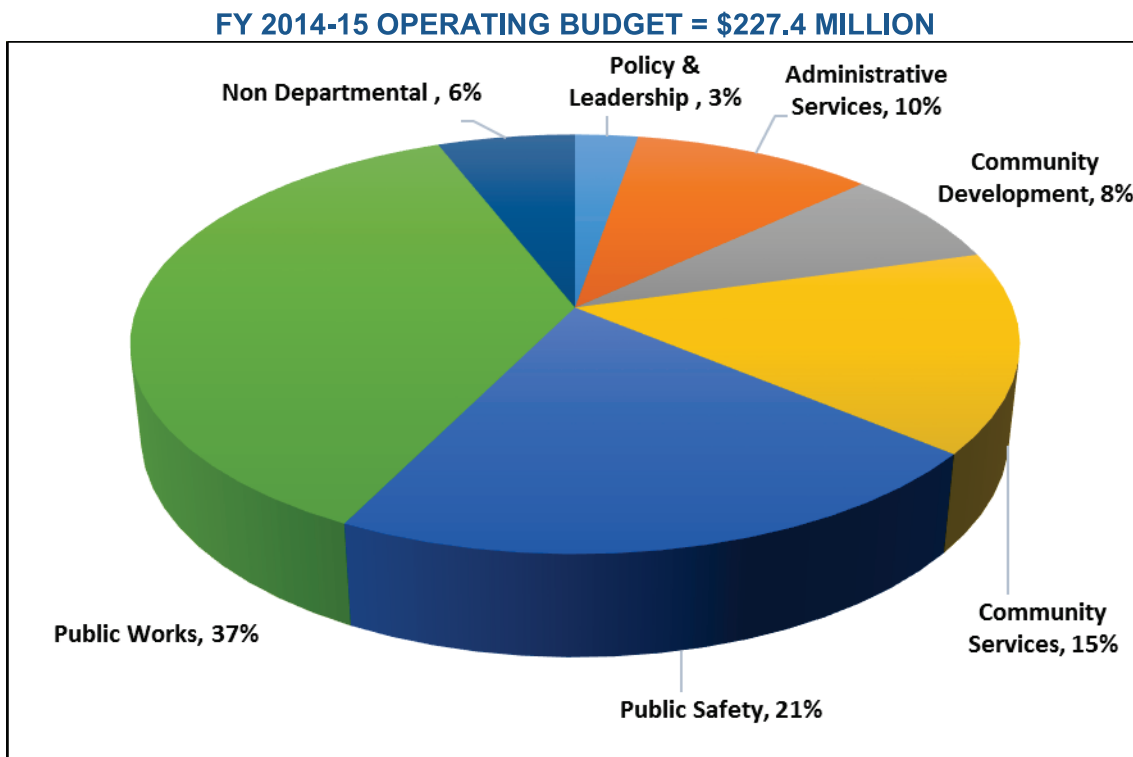
The Redevelopment Obligation Retirement Fund (RORF) revenues are expected to total \$2 million in the upcoming year. On June 29, 2011, California Governor Jerry Brown signed ABX1 26 to dissolve all redevelopment agencies within the State of California. All agencies were subsequently dissolved as of February 1, 2012, and a Successor Agency was designated to complete the work of the Carlsbad Redevelopment Agency (RDA) and satisfy the financial obligations. A Recognized Obligation Payment Schedule (ROPS) was prepared by the

CITY OF CARLSBAD BUDGET HIGHLIGHTS

Successor Agency in April 2012 which must ultimately be approved by the Oversight Board, the County of San Diego and the State of California. The initial ROPS identified financial commitments of the former RDA which will be paid from semi-annual tax increment revenue received by the Successor Agency. Every six months a new ROPS must be prepared and approved by the Oversight Board, the County of San Diego and the State of California in order to receive additional tax increment. Due to the dissolving of the RDA, the RORF will only receive tax increment revenues and interest earnings on any cash balances. Tax increment revenues are projected to decrease due to the increase in County of San Diego administrative costs which are netted against the tax increment revenues received by the Successor Agency.

Operating Budget By Program

The total Operating Budget adopted for the city for FY 2014-15 equals \$227.4 million, which is approximately 5.9 percent higher than the Operating Budget adopted for FY 2013-14. The Operating Budget includes funding for the General Fund as well as all other city funds, and can be categorized by main functional area. Six main functional areas that represent the key businesses of the city have been identified, as well as a Non-Departmental component which includes fund transfers as well as items that benefit the city as a whole. The graph below shows the percentage of the Operating Budget applicable to each of the functional areas.



Total funding allocated for the **Policy and Leadership Group** for 2014-15 is \$6.2 million. This group encompasses all elected officials and the chief executive offices for the city. These include the offices of the City Council, City Manager, City Clerk, City Attorney, City Treasurer, and the communications department.

Administrative Services, with a budget of \$23.6 million, includes finance, purchasing, human resources, information technology, records management, self-insured benefits, risk management, and workers' compensation. These areas mainly provide services to internal city departments.